International Updates

Canada Moves Toward Fuller Funding For Its Pension Plan

After more than 2 years of extensive national consultations and study, Parliament passed the ***Canada Pension Plan Investment Board Act*** at the end of 1997. The legislation establishes a board to invest assets of the Canada Pension Plan (CPP) as well as altering contribution rates and the benefit structure, effective January 1, 1998. Implementation of the investment board provisions was delayed until Spring to allow time for development of regulations relating to the board's operation.

The CPP is a compulsory, earnings-related social insurance program providing retirement, disability, and survivor pensions. All employees earning more than an exempt minimum amount contribute a percentage of their salary, up to the maximum pensionable income. Employers match employee contributions; the self-employed contribute the combined employee-employer amount. Benefits are calculated on the basis of accumulated pension credits, much like the U.S. earnings-based system.

The CPP is administered by the federal government and applies to all of Canada except the province of Quebec, which operates its own parallel Quebec Pension Plan (QPP). Contribution rates are the same and benefits are similar for the CPP and QPP, but Quebec administers its funds differently. Quebec has amended its own pension plan in such a way that both QPP and CPP now have the same changes in benefits and contributions, Matters in the new legislation relating to the Investment Board and investment of funds pertain only to the CPP.

Revision of the pension plan was propelled by the CPP's Fifteenth Actuarial Report (as of December 31, 1993), which projected the depletion of the CPP fund by the end of 2015 if the established schedule of contribution rates was followed. (That old schedule called for gradual annual increases in the combined employer-employee contributions, boosting them from 5.0 percent (2.5 percent from each) of covered earnings in 1993 to 10.1 percent in 2016 and onward to 14.2 percent in 2030.) Advocates of the new legislation claim the changes now instituted will not only prevent the fund's collapse but, after reaching a combined contribution rate of 9.9 percent, will put an end to rate increases for the foreseeable future.

To accomplish all this, the new law contains substantial changes to the pension plan. Although about one-fourth the impact of the revisions are projected to result from cost savings from some administrative modifications that were already in place and tightening some benefit requirements and provisions that became effective January 1, the major changes in the legislation involve financing. The new law moves the CPP away from an essentially pay-as-you-go system towards a more fully funded one.

As a pay-go operation, current contributions plus other revenues are intended to cover current benefit costs. To accommodate fluctuations in income or expenditures, the CPP account has an investment fund that holds the excess of CPP assets over immediate needs. This fund was mandated to maintain a reserve of approximately 2 years worth of anticipated payments. Since the inception of the CPP in 1966, the fund could make long term loans to provincial governments (at lower-than-market rates) when receipts exceeded payments, adding some investment income to the CPP. When contributions plus other income were less than payments, the investment fund was tapped to make up the difference. In each of the last four fiscal years total costs have been greater than CPP revenues and the investment fund has been reduced by more than C$4.4 billion. This is the fund the Fifteenth Actuarial Report predicted would be exhausted in 2015 unless something was done.

As a fuller-funded operation, CPP benefits will continue to be paid from current contributions but, as a consequence of the new legislation, the investment fund is now designed to amass an eventual reserve of about 5 years' payout. Financing changes intended to accomplish this include accelerating the increases in the combined worker-employer contribution rate, bringing it to a steady state of 9.9 percent in 2003 (instead of reaching that rate in 2015 as previously scheduled), and freezing the amount of minimum earnings exempt from CPP contributions at the 1997 level. This latter step will produce an expanded earnings base for future contributions since the upper limit of pensionable earnings will continue to rise in accordance with an established formula. The resulting enlarged investment fund is now expected to be a much more significant player in CPP financing.

The new CPP Investment Board will operate at arms length from government influence. The Board is to invest CPP funds in a diversified portfolio, eventually reducing CPP holdings of provincial securities to the same proportion as that held by other pension funds. Meanwhile, provincial governments will now be charged the same interest rate for new loans as they would have to pay any other lender.

During the year before submitting legislation to Parliament, the Canadian government conducted nationwide "consultations" with the announced purpose of seeking public input on eventual changes to the CPP. An information paper outlining issues and options was provided as a framework for the general discussions. The sessions elicited a full sweep of suggestions and perspectives including leaving the CPP as it was, enhancing benefits, reducing benefits, or replacing the plan altogether. However, the recurring theme according to the government's summarizing report was that "Canadians are deeply attached to the CPP and....want the plan's problems fixed quickly and fixed for good." That, the supporters of the recent legislation believe is just what has been done.

—Flan Fry

Cayman Islands Establishes Comprehensive Pension System

The Cayman Islands-a Caribbean dependent territory of the United Kingdom-are a thriving offshore financial center that has no direct taxation; 28,000 foreign companies do business with the 600 registered banks and trust companies, and banking assets exceed $500 billion. Tourism is also a mainstay, accounting for about 70 percent of the gross domestic product and 75 percent of foreign currency earnings. As a result of these business activities, the gross domestic product per capita in the Cayman Islands is the highest in the Caribbean, approaching that of the United States. However, the Caymans have no social security system.

National Pensions Law

In July 1996, the Cayman Islands Legislative Assembly passed "The National Pensions Law, 1996," which became effective on July 1, 1997. The law establishes a national system based on mandatory private/occupational pensions and provides for the establishment of defined contribution or defined benefit pension plans.' This provides the first comprehensive protection for earnings lost due to old age or disability. (The following applies to both defined contribution and defined benefit pension plans.)

Under this law, every employer in the Cayman Islands shall provide a pension plan or make contributions to a plan for all its employees aged 18-60. Self-employed persons are also required to be members of approved plans. The legislation covers both full- and part-time employees. Pension plans are established and maintained expressly for the benefit of Cayman Island employees; noncitizens and domestic workers in private homes are excluded from pension coverage.[2]

A National Pension Board and an Office of the Superintendent of Pensions are established to oversee the administration of the new plans. The minimum annual pension is to be equivalent to 1.5 percent of an employee's pensionable earnings for each year of participation, subject to a maximum of 40 years. Normal retirement is at age 61, although pension plans may specify later retirement dates. Both employees and employers must contribute 5 percent of the employee's earnings to the plan. Participants who are aged 45 or older, however, may elect to contribute a greater amount. The National Pensions Law provides for extensive, orderly administration, accounting, and record keeping, and, among other investment information guidelines, directs that a statement of benefits be sent yearly to each participant in the plan.

The draft[3] regulations specifically acknowledge that financial investment needs of groups vary according to the age of the employees. They, therefore, direct that the administrator, in selecting plan investments, must take into account the average age of its members.

In addition to retirement benefits, Cayman Island pension plans may provide benefits arising from additional voluntary contributions, death, or disability benefits. Moreover, the law stipulates that greater benefits be paid to a member with reduced life expectancy because of his/her disability. Members may also elect an early retirement pension if they are within 10 years of retirement age and meet additional requirements.

The National Pensions Law expressly prohibits sex discrimination regarding eligibility for, or amount of, plan benefits or provision of ancillary benefits.

Plan members (employees) and former members (ex-employees) may vote to establish a pension plan Advisory Committee (of which present and former employees comprise sole membership). These committees are empowered to monitor and make recommendations concerning plan administration, and to promote awareness and understanding about the plan to employees and all persons receiving benefits.

Regulations

On March 12, 1997, a few months before the National Pensions Law went into effect, two of the three draft sets of regulations intended to implement the legislation were released.4 The first concerns ***pension fund investments.*** This set deals, in considerable detail, with guidelines directing the activities of plan administrators, mandates various investment practices, and sets forth certain pension fund prohibitions. Regulations prescribe the practices of any entity or person--the administrator or the investment manager, for example-who may negotiate transactions for approved pension plans. It particularly tries to establish low-risk asset allocation to guide investment strategies and prohibits certain investments, such as investing fund assets in companies not traded publicly or investing in real estate, and also limits to 5 percent the aggregate amount of a pension fund that may be invested in, or loaned to, any corporation or country (though it specifically exempts United States Treasury securities from that limitation). Finally, the Pension Fund Investment Regulations specify the information that financial statements must provide and the distribution schedule to which they must adhere.

The second set lays out ***general*** regulations. This set deals, for example, with the processing of applications for the registration of plans and providers; contribution rates for the phase-in period; types of retirement savings arrangements into which the retiree's funds may be deposited; contents of the annual statement; and eligibility for a trust corporation's administration of a pension plan.

The third set, which is to concern ***valuation procedures*** for defined benefit pension plans and ***actuarial provisions,*** had not been made available at the time of release of source documents. In his written statement,[5] the Grand Cayman Minister of Community Development with Responsibility for Pensions, sought outside technical expertise to assist with the further drafting of this third set of regulations. Copies of the other two sets of regulations were publicly released for "ease of reference."

January 1, 1998-6 months after the law was to come into effect-was set as the target date for all employers to be in compliance with the new national law. The Minister declared that prospective approved providers and employers, by then, would be able to assess the "state-of-readiness" of their pension plans or "know what they needed to do to comply with the legislation." He went on to say that the legislation would thus ensure that all employees who contribute would "have proportionate resources to provide a decent retirement for them."

-Alexander Estrin and Corrinne Lennox

Notes

[1] According to definitions in the National Pensions Law of 1996, "defined contribution benefit" means a benefit determined and provided by contributions made by or for the credit of a member, together with the investment yield. The benefit is determined on an individual account basis. "Defined contribution pension plan" is a pension plan providing a defined contribution benefit.

"Defined benefit" means a benefit determined in advance that depends on various factors such as level of earnings and length of employment. A "defined benefit pension plan" is a plan providing such a benefit.

*This exclusion is significant; approximately three-eighths of the resident population are not Caymanians.

[3] The National Pensions (Pensions Fund Investments) Regulations 1997, official draft.

[4] Both sets of regulations are official but designated "draft."

[5] Statement by the Honourable W. McKeeva Bush, O.B.E., J.P., Ministry of Community Development with Responsibility for Pensions, March 12, 1997, "Release of the Draft Regulations to the National Pensions Law," George Town, Grand Cayman.